Minutes of WG2 Meeting

10am – 12pm Friday 10 January 2014

HMRC, Right Auditorium, 1 Horse Guards Road, London, SW1A 2HQ

Attendees

Ann Brennan (GE / BBA Rep)
David Boneham (CIOT / Deloitte)
Lara Okukenu (Deloitte)
Graham Williams (PwC)
Andrew Seagren (KPMG)
Catherine Linsey (ECI Partners)
Paul Baldwin (FTI Consulting)
Alex Jupp (Skadden)
Vincent Maguire (Clifford Chance)
Hugo Webb (Bingham McCutchen)
Ashley Greenbank (Macfarlanes)
Jonathan Richards (Ernst & Young)
Andrew Hastie (LBG)
Tom Cartwright (Pinsent Masons)
Kathryn Hiddleston (Grant Thornton)
Tim Lowe (Linklaters)
Graham Iversen (Slaughter and May & BVCA)
May Lam (Prudential / ABI Rep)

(collectively the "**group**")

Tony Sadler (HMRC) - **Chairman**
Mark Lafone (HMRC)
Richard Daniel (HMRC)
Roger Bath (HMRC)
Andrew Scott (HMRC)
Liz Ward-Penny (HMRC)

(collectively "**HMRC**")

Apologies

Stuart Sinclair (Bingham McCutchen)

1. Introductions and background

HMRC opened the meeting by summarising that the main focus was to discuss the draft partnership legislation circulated by HMRC on 19 December 2013.

HMRC thanked members of the group that had provided comments in advance of the meeting and suggested that these were addressed as part of the day's general discussions.

2. General overview

Before proceeding, HMRC reiterated that this exposure draft is only intended to cover the consolidation of the rules on partnerships, and the core principle, in a new Chapter 9. HMRC noted that they still need to address the issues of lending between partner and partnership, and changes in profit share ratios etc.

3. Section 302(2A) CTA 2009

HMRC: This subsection was to be inserted into the primary definition of a loan relationship (at section 302 CTA 2009).

To the extent that a company operates through a partnership which in turn is party to a money debt arising from a transaction of the lending of money, then section 302(2A) CTA 2009 points you towards the operative section 380A CTA 2009.

A member of the group commented that the current rules did not include any sign positing and therefore questioned whether section 302(2A) was necessary. HMRC commented that whilst it may not be necessary, it does no harm and so have a preference for it to remain.

4. Section 380A – General

HMRC: Some of the drafting in the new section 380A echoes quite closely what is currently in sections 467 and 472 CTA 2009.

5. Section 380A(1)

HMRC: Subsection (1) states when section 380A should apply.

A member of the group highlighted the use of the words "trade or other business" and queried whether this drafting caused some confusion on the basis that a partnership must have a business and ergo a trade must be a form of business.

HMRC questioned whether anything turned on this matter. The group did not consider that it did. HMRC however confirmed that they would discuss the drafting with parliamentary counsel.

6. Section 380A(2)

HMRC: Subsection (2) then states the base case deeming provision.

'Apportioned'

HMRC highlighted that one of the earlier comments fed back had been whether subsection (2) effectively resulted in an apportionment, in particular noting the lack of an explicit reference to the term at subsections (2)(a) and (b).

In response, HMRC suggested that the act of apportionment was implicit in the drafting. A member of the group supported this view, in particular highlighting the drafting at subsection 2(d):

as if anything.

(i) which is done by or in relation to the firm in connection with a money debt to which the firm is a party, and

*(ii) can sensibly **be apportioned** between shares of the debt,is, so far as done in connection with the share of the debt treated by paragraph (a) **as apportioned** to a partner, done by or in relation to that partner.*

Another member of the group queried whether the term "apportioned" was the correct term to use, given that subsection (2)(a) effectively deems the partner to stand in the firm's position as regards a given portion of the money debt. In other words, if the partner is deemed to be a party to the debt then why do amounts need to be apportioned to it?

HMRC confirmed that they would put this to parliamentary counsel.

What can and can't be apportioned

HMRC commented that the difficulty experienced in drafting subsections 2(c) and (d) was that some things can obviously be apportioned (e.g. shares) but others (e.g. voting, purpose, acts of the partnership etc.) were not so straightforward. Essentially, the intention behind these subsections was therefore that, if it was possible to apportion and if not, then use common sense.

A member of the group questioned whether in determining the "purpose" of being party to a loan relationship etc, one could simply look to the act of the partnership and then deem that to apply to all partners in line with their appropriate share.

HMRC commented that this common sense approach was what they felt to be achieved by subsection (c).

The same member of the group queried whether, in light of the many debates around purpose, it would not be clearer to have this drafted in legislation.

HMRC commented that they would consider this, but that it may be a matter better addressed in guidance.

Members of the group also highlighted the qualification given to subsection (c) (by virtue of the phrase "other than to which paragraph (d) applies") and queried why this qualification was not also given to subsection (b). A member of the group suggested that, unless such drafting was intentional, this mismatch could be easily rectified by merging subsections (b) and (c) and having what is currently subsection (d) effectively qualify both.

HMRC commented that the intention was for subsection (d) to qualify both subsection (b) and (c) and that in their opinion this was achieved by reading the subsections of section 380A(2) cumulatively. HMRC confirmed that they would however take on-board the suggestion made.

In addition, HMRC also flagged the need to consider use of the term 'sensibly' in subsection (d)(ii) with a member of HMRC suggesting removing it all together. The group generally agreed with this sentiment.

HMRC agreed to take away the aforementioned points and discuss with parliamentary counsel. HMRC commented that ultimately the difficulty would be that the act of apportioning can only be taken so far and that for some matters, this is purely academic exercise (i.e. as nothing turns on whether that matter can be apportioned or not).

7. Section 380A(3)

HMRC: Section 380(2A) states what you should do and section 380A(3) is intended to state what you should not do.

A member from HMRC commented that in order for the drafting to flow better it would be preferable for the word "accordingly" to be inserted at the commencement of subsection (3).

Certain members of the group questioned whether subsection (3) was simply declaratory and therefore not needed i.e. once the partner is deemed party to the loan relationship it should be clear that section 1259 CTA 2009 cannot apply to profits and losses of that loan relationship as section 1259 CTA 2009 operates by reference to the firm.

HMRC agreed that this subsection was purely declaratory but considered that it helped put the matter beyond doubt.

8. Section 380A(4)

Single set of partnership accounts? Or, deemed partnership accounts?

HMRC: This subsection is intended to instruct the corporate partner to determine debits and credits by reference to the accounts of the firm.

A member of the group commented that in his view, the current drafting did not make explicitly clear whether, in the case where GAAP compliant partnership accounts do not exist:

(i) A single set of GAAP compliant partnership accounts must be drawn up by the firm; or

(ii) Whether the corporate partners were to draw up GAAP compliant partnership accounts (or extracts from them) purely for computational purposes.

This member noted that c.12months ago, it was estimated that of the 20,000 registered English LLP's; 5,000 to 8,000 were private equity investments, most of which would not have prepared GAAP compliant accounts.

In this context, the subtle distinction between (i) and (ii) could have large commercial ramifications if the legislation were to require a single set of GAAP compliant partnership accounts. For example, if such an onus fell on the general partner, this could result in the general partner being held liable should the partners incorrectly self asses based on not fit for purpose accounts.

Transparency

A member of the group questioned whether bringing credits and debits into account by reference to the firm's accounts was the most appropriate method on the basis that, referencing the firm's accounts in some ways contradicts what is understood to be the policy objective of making partnerships more transparent.

HMRC acknowledged this point confirming that this view had previously been expressed at the meeting held on 23 October, particularly in the context of differences between the firm accounts and partner accounts in the context of functional currency and financial instruments accounting (e.g. fair value vs amortised cost).

9. Other matters raised

(i) Subsection (4) currently omits drafting which addresses the case where there is a general partner in a limited partnership which is an investment scheme, but HMRC commented that this would be included in a future exposure draft.

(ii) The formula in subsection (5) does not reference GAAP compliant accounts.

Section 332 & (draft) section 380 CTA 2009

A member of the group flagged the interaction of section 332 and section 380 as an element of the current (and possibly the reformed) rules for partnerships in relation to loan relationships that produced anomalous results.

Currently, section 332 operates in certain circumstances, to treat a company as being subject to corporation tax under the loans relationship rules in respect of loan relationship even though the company had ceased to be party to them. The provision addresses repo arrangements but is not limited to such transactions.

Certain commercial structures involve the sale of loan relationships to a partnership, of which the seller is a partner. Where section 332 applies to the seller, this carries the prospect of a company being subject to double taxation – first under section 322, and secondly by apportionment under section 380 or a successor provision.

HMRC noted the view but indicated that the current priority was the drafting of the core principle and consolidating the partnership rules in a new Chapter 9.

6. Next steps & Timing

HMRC noted that they are still hoping to publish draft legislation soon but that they will make every effort to incorporate the feedback received both at the meeting and in separate comments.

It was reiterated that the published exposure draft would still be a consultation draft and not the final version for Finance Bill 2014.

HMRC also commented that if it was not possible to include legislation on changes in profit share ratios in Finance Bill 2014, this aspect may need to be delayed until Finance Bill 2015.

[Since this meeting, HMRC has published a revised exposure draft on the changes to the rules on partnerships in the loan relationships regime, together with the Explanatory Note and the Tax Information and Impact Note, all of which is available at:

https://www.gov.uk/government/publications/finance-bill-2014-january-2014-draft-legislation]